

General Information Letter: Alabama net operating loss for individuals has no equivalent in computing base income, and so is not taken into account in computing double-taxed income.

September 26, 2002

Dear:

This is in response to your letter dated September 11, 2002, in which you request a ruling. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.revenue.state.il.us.

In your letter you have stated the following:

We are writing on behalf of the above taxpayers in regard to the notice referenced above (copy enclosed). The notice proposed a change in the taxpayers' credit for tax paid to other states from \$1,141 to \$784, thereby decreasing the overpayment applied to 2002 from \$16,963 to \$16,606 (a change of \$357). We respectfully disagree with the change you have proposed.

The taxpayers had Alabama taxable income as adjusted (Form NOL-85A, line 13) of \$38,074 after net operating loss adjustments. They paid income tax of \$1,823 (Form NOL-85A, line 14, as calculated on the tax table enclosed). Your notice changed the tax paid to Alabama on Illinois Schedule CR by prorating based upon the income double taxed (\$38,074/\$88,507). However, this proration should only be done when the entire taxable income is not taxed in Alabama. If Alabama calculated their tax on \$88,507 (page 1, line 19), then Alabama tax would have been \$4,348 (see tax table) instead of \$1,823. Alabama taxed only the \$38,074; therefore, no proration is required or supported on the Illinois Schedule CR.

We are enclosing a copy of the Alabama return and an original copy of the Illinois return that we filed to substantiate our position.

The Alabama Form 40NR you enclosed shows that the Zs had \$116,424 in federal adjusted gross income from Alabama sources in 2001. This amount was reduced by \$4,540 in itemized deductions, a \$23,324 deduction for federal income tax paid, and a personal exemption of \$53, resulting in taxable income of \$88,507. However, on Form NOL-85A, the \$116,424 in Alabama-sourced adjusted gross income was reduced by \$68,636 in Alabama net operating losses, and then by itemized deductions of \$14, a deduction for federal income tax of \$9,678, and a personal exemption of \$22. Alabama income tax of \$1,823 was actually computed on the resulting \$38,074.

On the Illinois Schedule CR, the Zs reported income taxed by Alabama and Illinois as \$38,074. This is 0.846% of their \$4,501,704 in base income, so the credit was limited to 0.846% of the \$134,871 in Illinois tax due before credits, or \$1,141. Accordingly, that is the amount of credit claimed.

The Department pro-rated the \$1,823 in Alabama taxes paid as you described, determining that \$784 in tax was actually attributable to the \$38,074 in double-taxed income reported by the Zs, and allowing that amount as the credit.

Response

Section 601(b)(3) of the Illinois Income Tax Act (35 ILCS 5/601) provides:

The aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act shall be credited against the tax imposed by subsections 201(a) and (b) otherwise due under this Act for such taxable year. The aggregate credit provided under this paragraph shall not exceed that amount which bears the same ratio to the tax imposed by subsections 201(a) and (b) otherwise due under this Act as the amount of the taxpayer's base income subject to tax both by such other state or states and by this State bears to his total base income subject to tax by this State for the taxable year.

Effective August 23, 2002, the Department has published final regulations, 86 Ill. Admin. Code Section 100.2197 providing guidance on how this "foreign tax credit" is computed. Section 100.2197(b)(4) provides that the amount of the taxpayer's base income subject to tax by another state and by Illinois (referred to as "double-taxed income"):

means items of income minus items deducted or excluded in computing the tax for which credit is claimed, to the extent such items of income, deduction or exclusion are taken into account in the computation of base income under IITA Section 203 for the person claiming the credit.

Under this provision, an item of income is taken into account in computing double-taxed income only to the extent it is included in the tax base of the other state and in Illinois. See subsection (b)(4)(B). On the other hand, standard deductions or exemptions are not taken into account at all because the computation of base income is made without regard to such items (see subsection (b)(4)(A)) and expenses are allowed as a deduction only to the extent both states allow the deduction. See subsection (b)(4)(D).

Applying these principles, double-taxed income for Alabama would be the \$116,424 in federal adjusted gross income from Alabama sources. Because the computation of Illinois base income begins with federal adjusted gross income, all items of income and deduction taken into account in determining Alabama-sourced adjusted gross income are taken into account by Illinois. On the other hand, the deductions shown on the Zs' Alabama Form 40NR in the amounts of \$4,540 for itemized deductions, \$23,324 for federal income taxes paid and \$53 for personal exemptions would not be taken into account, because Illinois does not allow these deductions in computing base income. Finally, the \$68,636 in Alabama net operating losses and the reduced deductions allowed for itemized deductions, federal income taxes paid and personal exemptions taken on Alabama Form NOL-85A would not be taken into account in determining double-taxed income, because Illinois does not allow these deductions.

As you state in your letter, there is no basis for pro-rating or otherwise adjusting the \$1,823 in income tax paid to Alabama for 2001 for purposes of computing the Zs' foreign tax credit.

Accordingly, the \$38,074 in double-taxed income reported on the Zs' Schedule CR is understated. It should be \$116,424. When this amount is used to compute the limitation on the credit, that limitation exceeds the \$1,823 in tax paid to Alabama. The credit allowable on the Schedule CR should therefore be \$1,823.

In order to obtain a refund of full amount claimed on the original return plus the additional amount due under the regulations as described above, you should file an amended return with a corrected Schedule CR. Please attach a copy of this letter to that return to expedite processing.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy General Counsel -- Income Tax